Clark County, Washington

Investment Management Review
First Quarter 2001

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The first quarter saw short-term rates fall substantially as the Federal Reserve responded aggressively to a sharp slowdown in the economy. The bond markets responded with yields on maturities less than one year falling over 125 basis points (1.25%). Longer-term issues responded only slightly with the yield on the 30-year Treasury Bond actually increasing during the quarter.

The County pool portfolio had a par value of $353 million as of March 31st, a decline from the previous quarter's $384 million. The portfolio was slightly restructured shifting away from Commercial Paper into the Washington State LGIP. The pool portfolio remained well diversified by sector and maintained a high overall credit quality, liquidity, and exposure to call/reinvestment risk. A summary of first quarter highlights and PFM's recommendations follow.

- ***Asset Diversification –*** The asset allocation of the portfolio changed slightly quarter-over-quarter. The allocation to Commercial Paper was shifted to the State LGIP to take advantage of favorable short-term rates in this investment sector.

Sector Composition Comparison

	3/31/00	12/31/00	3/31/01	Quarter Change
Certificates of Deposit	0.0%	1.3%	1.4%	0.1%
Commercial Paper	8.6%	16.9%	0.0%	(16.9%)
Federal Agency Discount Notes	2.8%	3.9%	4.3%	0.3%
Federal Agency Notes	54.0%	58.7%	61.0%	2.3%
Treasury Securities	12.4%	7.8%	8.5%	0.7%
Municipal Obligations	0.0%	1.3%	1.4%	0.1%
Passbook/Money Market Accts	22.2%	10.0%	23.4%	13.4%
Totals	100%	100%	100%	

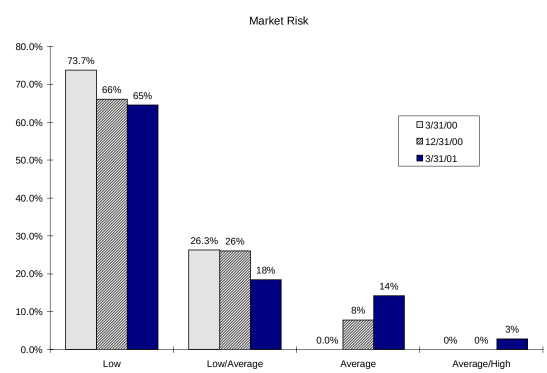
*Based on par values of securities in pool portfolio.

- ***Maturity Distribution –*** The County's pool portfolio maintained an average maturity of roughly 10.6 months during the quarter. PFM's suggested maturity target for the County's portfolio continues to be 9-10 months. Therefore, we would recommend allowing the portfolio's average maturity to drift lower, while concentrating any new purchases in shorter maturities. We believe that the 12 to 24-month maturity range offers the best value for the core portfolio.

- ***Credit Quality*** – The County maintained the portfolio's low exposure to credit risk. As of March 31, 74% of the portfolio was invested in securities rated "AAA" (highest long-term rating) or "A-1/P-1" (highest short-term rating). 23.2% of the portfolio was invested in the un-rated LGIP.

- ***Liquidity –*** As of the quarter end, 97% of portfolio assets were categorized in one of PFM's top three liquidity rating categories (1, 2, and 3). The overall weighted liquidity factor was 2.67 well within PFM's recommended range of 2 to 4.

- ***Market Risk*** –The Pool remains principally invested in securities maturing under 2-years as of March 31, classifying 83% of the portfolio in the low to low/average categories of market risk. This represents a slight increase in market risk since December 31, 2000, when 92% of the portfolio was invested in securities with maturities under 2-years.



- ***Callable Exposure*** – The total portfolio exposure to call risk remained at 13%. This allocation is in line with PFM's maximum recommended limit of 20% to 25%.

As described in more detail in the accompanying report, the investment strategy employed by the County Pool appears to be prudent and appropriate given the County's historic cash flow patters and current market conditions.

2001 Economic Summary

The bond market rally that began in May 2000 continued in strength in the first quarter of 2001, as a stream of negative economic data, highlighted by weak manufacturing output and deteriorating consumer confidence, convinced investors that the economy had slowed considerably. This view was reinforced when the Federal Open Market Committee reduced the overnight bank borrowing rate by 1.50% in three steps during the first quarter, and stock prices plummeted to their lowest levels in more than two years. Short and intermediate-term Treasury rates fell dramatically. At one point during the quarter, the yield on the 2-year Treasury Note was as great as 95 basis points (0.95%) below its yield at the end of the fourth quarter.

2 Year U.S. Treasury Yield History
January 3, 2000--May 23, 2001

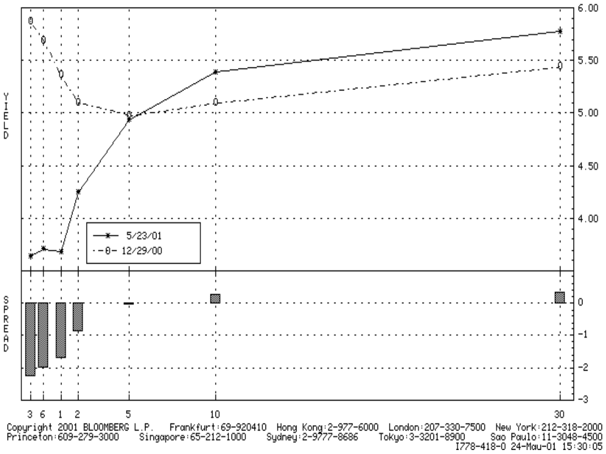
Although several more recent economic indicators have shown slight improvement, the U.S. economy remains weak. The Federal Reserve continued to ease monetary policy with two additional 50 basis point cuts during the second quarter, lowering the Federal Funds Rate to 4.00%.

This significant move in the bond market resulted in stellar returns for the first quarter, and rounded out a year in which investors in intermediate-term securities achieved double-digit total returns. Investments in Treasuries, represented by the Merrill Lynch 1-3 year Treasury Index had an annualized total return of 11.68%, while the 1-3 year Agency benchmark returned 11.65% during the first quarter. For the year, the Merrill Lynch 1-3 year Treasury Index returned 9.60% compared to a 10.29% return for the 1-3 year Agency Index. Intermediate-term portfolios did even better. The annualized total return of the Merrill Lynch 3-5 year Treasury Index was 13.39% for the quarter and 13.94% for the Agency Index. For the year, the Merrill Lynch 3-5 year Treasury Index returned 12.52% compared to a 13.15% return for the Merrill Lynch 3-5 year Agency Index.

Economic data released in the first three months of 2001 showed some troubling trends. Many economic indicators set lows that have not been seen since the last recession, which occurred over 10 years ago. Early in the quarter, Federal Reserve Chairman Alan Greenspan forecast that real economic growth during the first half of 2001 would be “at or near zero percent”. This bleak short-term outlook is shared by corporate America. A number of companies have announced that their financial results for the first quarter and the remainder of the year would fall short of expectations. These warnings on corporate profits took a heavy toll on the equity markets: the tech-heavy NASDAQ Composite fell by an additional 26% during the quarter, and the value of the broader Standard & Poor’s 500 Index decreased by 12%. The Federal Reserve has been aggressively using monetary policy to help revitalize the economy. After five rate cuts this year, expectations on the health of the economy is finally improving which has led to a market rally in the broader stock market indices. The NASDAQ Composite is up 42% from its 52-week lows and the S&P 500 Index is 21% higher than its lows observed in April. Lower interest rates and stability in the stock markets should help in maintaining consumer confidence and prevent the economy from slipping into recession.

After nearly a year with an inverted U.S. Treasury yield curve, short-term yields declined dramatically causing the yield curve to return to a more ‘traditional’ positive slope. So far this year, three-month and six-month Treasury rates declined by 224 basis points (2.24%) and 198 basis points (1.98%) respectively.

U.S. Treasury Yield Curve
December 29, 2000 vs. May 23, 2001



	12/29/00	5/23/01	CHANGE
3 MONTH	5.881	3.642	-2.2385
6 MONTH	5.689	3.707	-1.9821
1 YEAR	5.361	3.689	-1.6728
2 YEAR	5.100	4.245	-0.8547
5 YEAR	4.978	4.940	-0.0380
10 YEAR	5.108	5.391	0.2831
30 YEAR	5.453	5.785	0.3318

The current yield on the three-month Treasury bill is 3.64%, which is below the overnight Federal Funds Rate of 4.0%. This would suggest that the market anticipates further easing by the FOMC in the coming months. Intermediate-term rates also declined significantly. The yield on the 2-year Treasury note fell by 85 basis points (0.85%) to 4.25%, which is approaching the trough of rates seen in the 1992-1993 economic recovery and the 1998 Asian Market Crisis. Longer maturities failed to participate in the rally, with the yield on the 30-year Treasury bond, in fact, increasing by 33 basis points (0.33%).

Federal Agencies performed well in the first quarter, generating higher returns than Treasuries. Highly rated (AA and AAA) corporates outperformed Agencies, while corporates rated A and below produced significantly lower returns. Spreads were wide among corporates, as the recent economic downturn raised credit concerns for lesser-rated corporates making those one of the worst performing sectors in the bond market.

Economic Releases

A wave of economic data continues to support the notion that the U.S. economy is in the midst of a dramatic slowdown.

EMPLOYMENT After setting a 30-year low late last year, the unemployment rate inched upwards to 4.5% in April. Initial jobless claims continue to trend higher with new claims spiking in late April at 425,000. Non-farm payrolls came in far below expectations in April falling a staggering 223,000 jobs. Future employment data is expected to show further weakness, as over 400,000 layoffs taking effect this year were announced during the quarter.

GROSS DOMESTIC PRODUCT (GDP) In what was the weakest quarter since the spring of 1995, the final GDP numbers for the fourth quarter saw a downward revision to 1.0% (annualized growth). The revision was due to expenditures being slightly lower than originally thought. The implicit price deflator rose by 2.0% (annualized)—a 0.4% increase from the third quarter. GDP growth during the first quarter was better than anticipated growing at an annualized rate of 2.0% during the period. Although GDP improved during the quarter, growth remains well below the U.S. economy's potential of 4.0%.

CONSUMER CONFIDENCE During Alan Greenspan's semiannual testimony on monetary policy, he outlined two possible paths for the economy going forward. The first path was a V-shaped rebound as the inventory liquidation is completed and the economy picks up. The second path was a more prolonged period of weakness, which he envisions if consumers "breach the fabric of confidence." As consumer confidence plummeted in January and February to a level unseen since October 1996, the Fed most likely felt that immediate action needed to be taken to curtail this growing pessimism on the part of consumers.

After improving in March, consumer confidence did not hold up in April with this index falling 7.7 points to a reading of 109.2

RETAIL SALES As Americans saw the wealth accumulated in a 10-year bull market reduced and uncertainty in the economic conditions going forward, many consumers have cut back their spending. Retail sales in January grew at a 1.3% rate only because of deep discounts on behalf of retailers to attract customers to clear excess inventory accumulated during the holiday season. Broad-based declines in February resulted in a reduction in retail sales of 0.2%. Excluding autos, retail sales were even weaker, dropping 0.3%. Durable goods sales were unchanged as a 1.6% increase in building materials offset a 1.9% decline in furniture sales. Seasonally adjusted year-over-year retail sales grew at a 3.1% rate in April, compared to a robust 9.3% growth rate last year.

MANUFACTURING ACTIVITY The National Association of Purchasing Managers (NAPM) Index, a measure of manufacturing activity, rose to 43.2% in April after snapping an 11-month slide in February. The index remains below the key 50.0% level for the ninth consecutive month. In fact, the average level of the NAPM in the first quarter was the lowest since the first quarter of 1991. This trend of weakness was likely an important consideration for the Federal Reserve's decision to lower rates so dramatically this year. The index remains at a level indicative of a recession in the manufacturing sector.

National Association of Purchasing Managers Index
January 1990 – April 2001

CONSUMER AND PRODUCER PRICES Consumer prices showed moderate gains in April, advancing by 0.3%, while the core CPI (which excludes food and energy prices) rose by 0.2%. April's PPI release indicated little to no inflationary pressures on the economy, as producer prices were only up by 0.3% over March. Excluding the volatile food and energy components, the core PPI increased by 0.2%. This report confirms that inflation is in-line with prior months and that the larger than expected increased in the CPI and PPI during January were simply aberrations due to a spike in energy costs. These inflationary gauges continue to remain in check, allowing the Federal Reserve to ease monetary policy without the fear of inflation.

Sector Distribution

The table below illustrates the change in the portfolio composition of the County pool from the end of the fourth and first quarters, as well as one year ago. During the recent quarter, $40 million of proceeds from maturing or called securities were reinvested in Federal Agency obligations. This slightly increased the allocation to the Federal Agency sector from 62.6% as of December 31, 2000, to 65.2% as of March 31, 2001. As the Federal Reserve cut short-term rates dramatically during the quarter, yields on money market accounts 'lag' alternative market sectors and typically offer higher yields than these other sectors. The County recognized this yield enhancing opportunity by shifting its allocation from commercial paper to the Washington State LGIP during the quarter. The allocation to money market accounts increased from 10.0% to 23.4%. We would recommend the County Pool maintain a high allocation to the Washington State Pool since the May 15th rate cut has not been fully reflected in the yields of most money market funds. The portfolio continues to be most heavily weighted in Federal Agency securities. As of March 31, 2001, the portfolio remains well diversified.

Sector Composition Comparison

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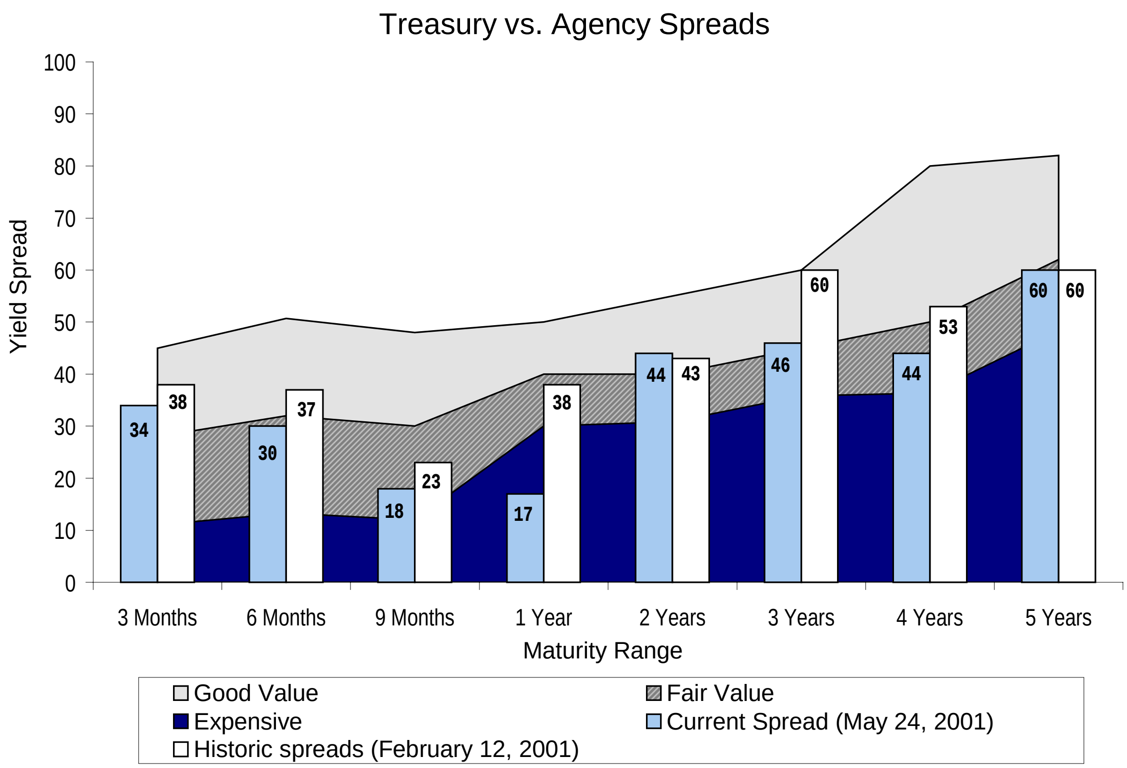
Totals	100%	100%	100%	

*Based on par values of securities in pool portfolio.

Yield spreads between Treasuries and Agencies remained relatively wide on a historical basis during the first quarter. Generally, Federal Agency securities represent good value across the yield curve, as illustrated in the chart below. We would suggest that the County maintain its current sector distribution or possibly further increase its allocation to Agencies to the limits of the investment policy. If yield spreads were to tighten significantly between the two sectors in the future, we would then suggest the County increase the allocation to Treasuries.

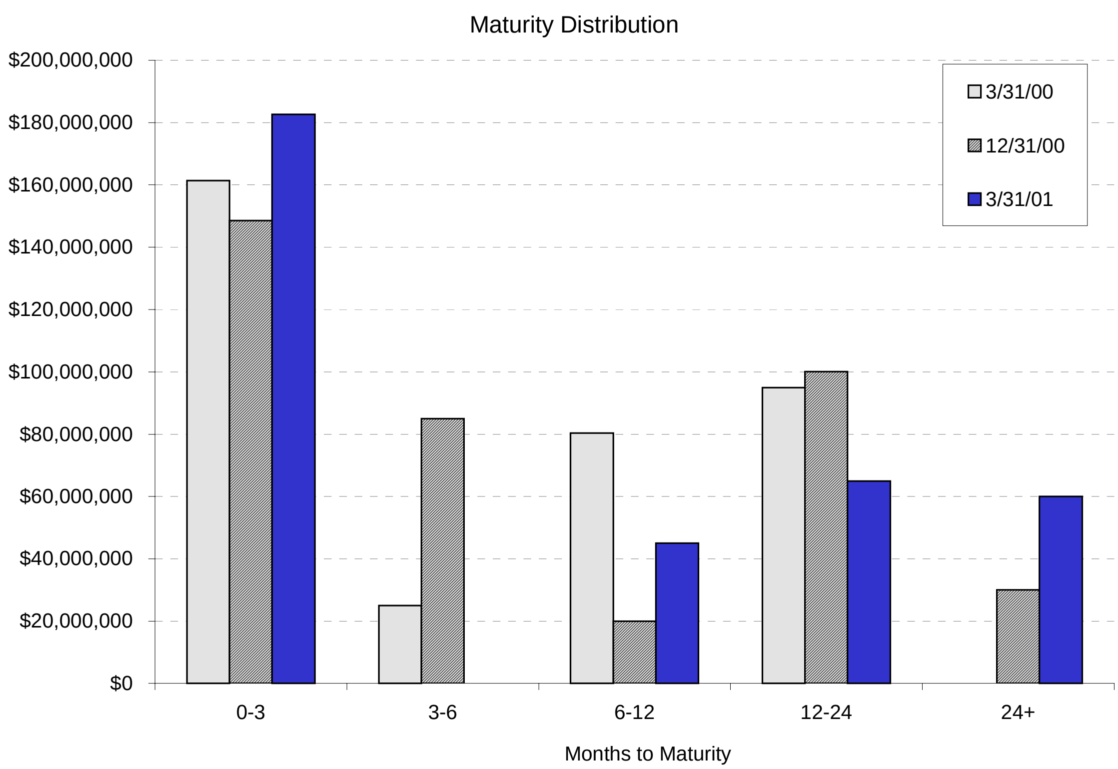


Maturity Distribution

As of March 31, the portfolio remained very liquid with nearly 52% maturing within 3 months. During the first quarter, the average maturity modestly increased from 8.5 months (258 days) on December 31, 2000, to 10.6 months (317 days) on March 31, 2001.

Allocation to securities maturing in the 3-6 month maturity range declined substantially as assets were shifted to the State LGIP. The allocation to maturities beyond 24 months increased due to the addition of 3-5 year callable Federal Agencies. PFM continues to recommend that the target duration of the Pool be in the range of 9 to 10 months.

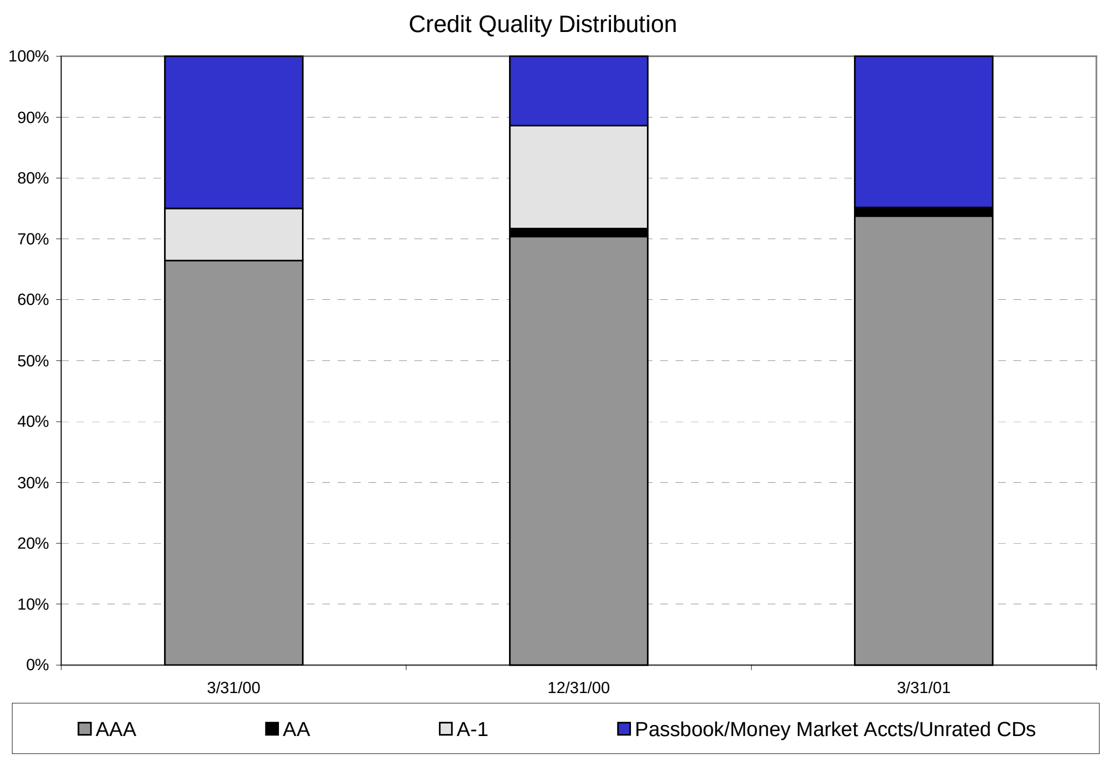
The chart below illustrates the maturity distribution of the County's portfolio as of March 31, 2001, the prior quarter end, and the distribution a full year ago.



Credit Quality

As of March 31, 2001, 74% of the portfolio was invested in obligations rated "AAA" or "A-1/P-1", compared to 87% invested in "AAA" and "A-1/P-1" as of December 31. This shift in allocation can be attributed to the reallocation of funds from commercial paper, which carries a credit rating, to the non-rated Washington State Local Government Investment Pool. The overall high credit quality of the portfolio continues to be maintained by the County's investment strategy.

The chart below shows the credit quality distribution of the portfolio as of March 31, 2001, compared to December 31, 2000, and March 31, 2000.

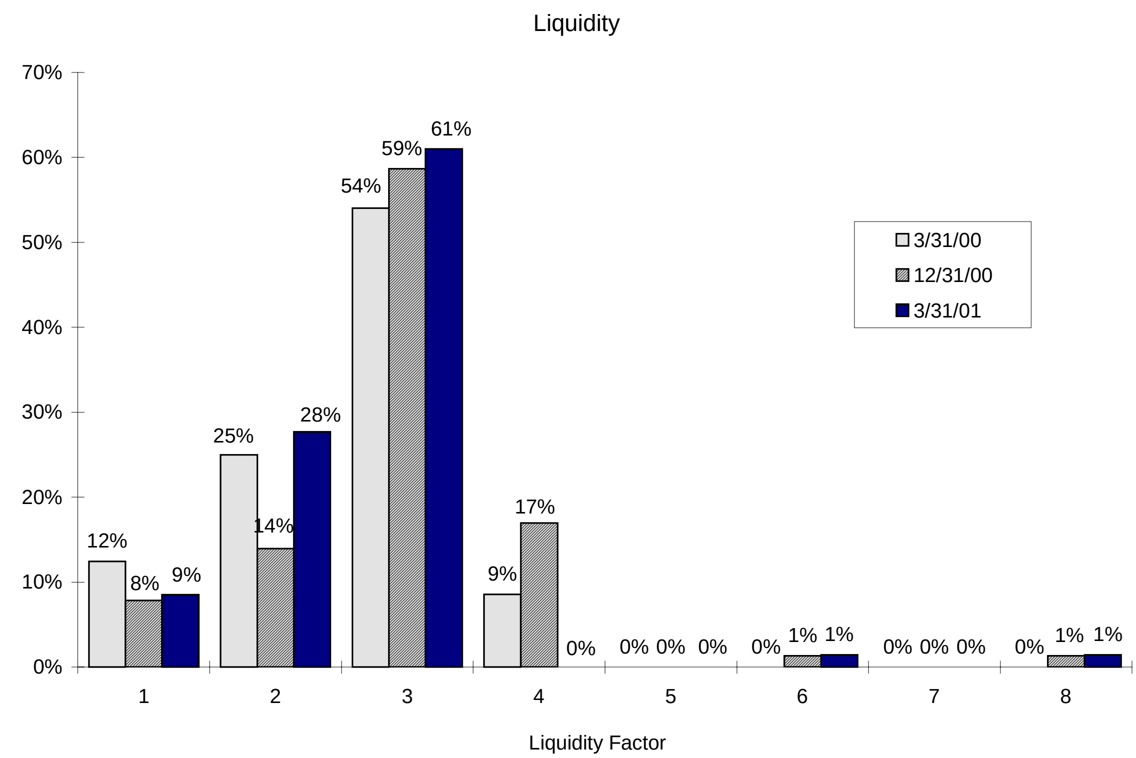


Liquidity

The County's portfolio remains highly liquid. As of March 31, 2001, 97% of the portfolio was invested in obligations rated among one of PFM's four highest liquidity-rating categories (1, 2, 3, and 4), with the remaining 3% invested in negotiable certificates of deposit and municipal obligations.

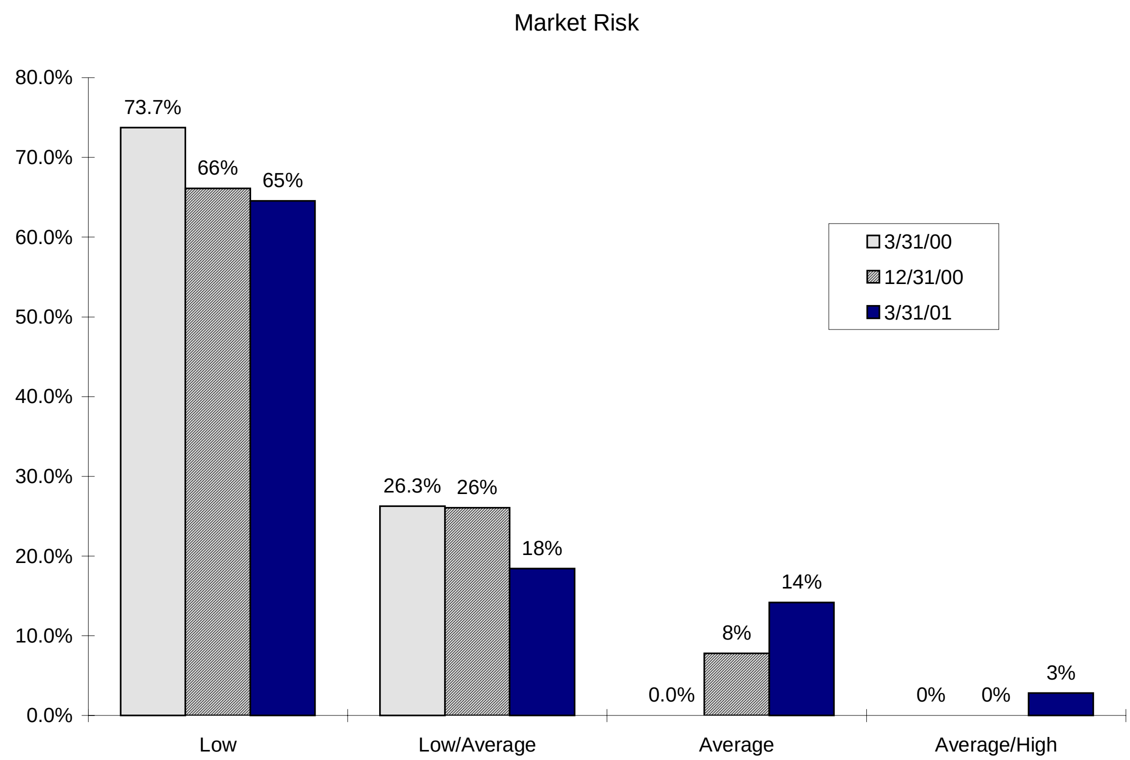
During the quarter, the average-weighted liquidity of the portfolio declined slightly from 2.98 as of December 31, 2000, to 2.67 as of March 31, 2001. This improvement was due to the shifting of funds from commercial paper to the State LGIP. The portfolio remains well within PFM's recommended liquidity range of 2 to 4.

The chart below shows the liquidity distribution of the portfolio as of March 31, 2001, compared to December 31, 2000, and March 31, 2000. Category 1 represents securities that can be easily sold with little difference between the bid and offer prices, such as U.S. Treasuries. Category 8 represents securities that are generally considered illiquid such as non-negotiable certificates of deposit.



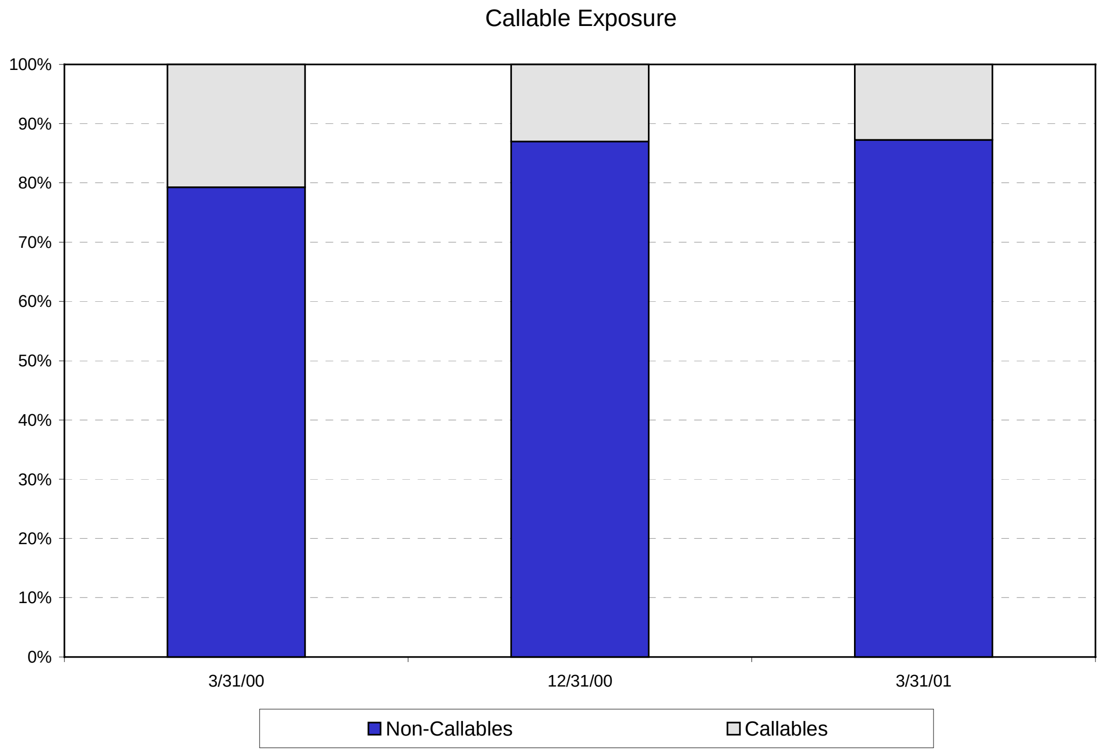
Market Risk

Approximately 65% of the portfolio is invested in securities with maturity dates less than 365 days. These holdings are classified as having a low exposure to market risk. Fully 83% of the portfolio was invested in securities with maturities under 2 years and can be categorized as maintaining a low or low/average exposure to market risk. The addition of the 3-year callable securities increased the allocation by 6% to the category of average exposure to market risk. $60 million par was invested in securities that matured beyond two years at the end of the quarter. The chart below shows the portfolio's exposure to market risk as of the current quarter end, 3 months ago, and one year ago.



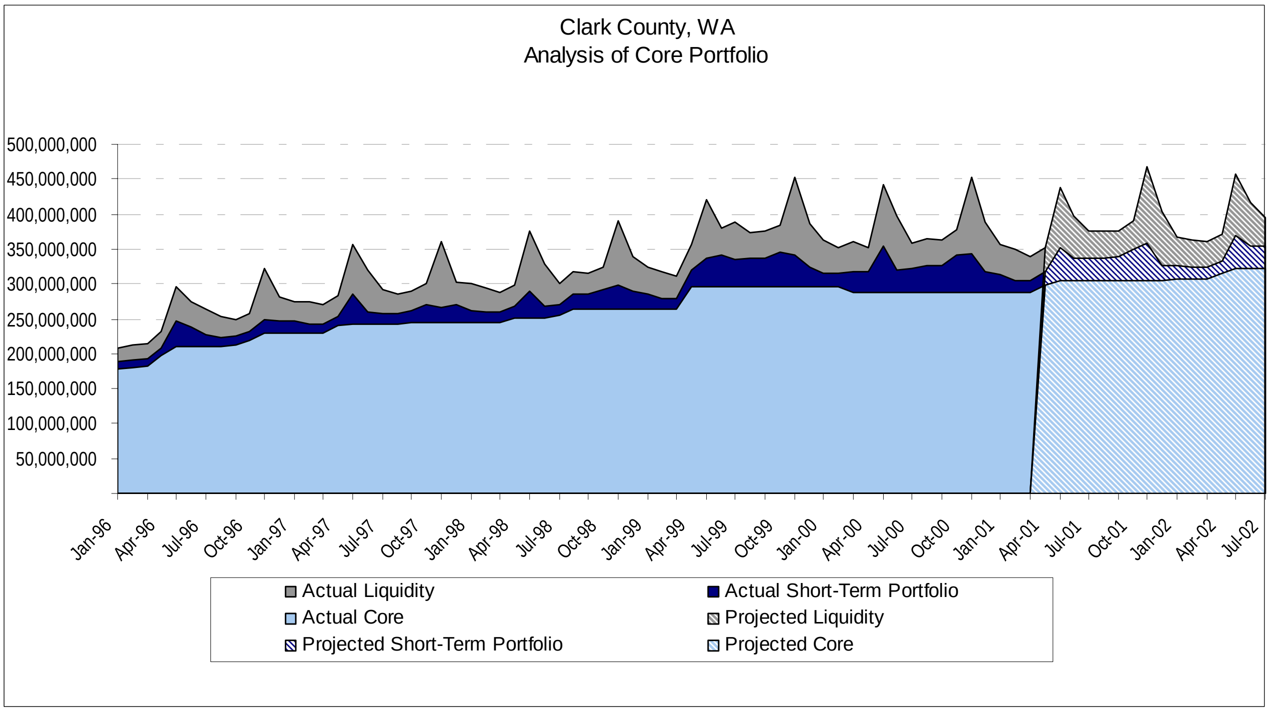
Call Exposure

The portfolio's allocation to callable obligations remained unchanged at 13% during the quarter. The pool held $45 million par in callable Federal Agencies as of March 31. This is well within PFM's recommended maximum of 20-25% allocation in callable securities.



The chart below represents cash flow projections for the County's portfolio. The model is based on changes in historic balances from January 1996 to March 2001. The data on the left side of the chart represents actual historical data. The data on the right side represents projected balances. Projections are based on historical seasonality[1] and a 5% annual growth rate.

The portfolio is allocated among the following three components: 1) Liquidity – representing funds needed to cover cash needs in the upcoming month. These funds are to be invested in very short-term money market instruments and the State LGIP. 2) Short-term portfolio – this includes funds set aside to provide liquidity for anticipated disbursements in two to six months and an added cushion should liquidity requirements suddenly increase. And 3) Core – this represents the portion of the portfolio that can be invested in longer-term obligations to achieve higher rates of return over the long run.



As reflected by the chart, the County's portfolio balance predictably reaches its peaks in May and November and its low points in March and September. The results of this analysis suggest that the portfolio will experience a net cash inflow during the second quarter.

[1] A predictable change in the monthly balance from year-to-year due to the timing of cash inflows and outflows.

The following table focuses on the relative value of shorter-term investments between sectors. The table illustrates the current yield spreads and the 6-month average spreads of various securities as compared to U.S. Treasury Bills in the same maturity range. The table also provides an evaluation and current outlook of PFM portfolio managers on the short-term market. Since the County needs to maintain a relatively high degree of liquidity in its portfolio, this may serve as an additional reference for evaluating trade opportunities in the current market.

REVIEW OF INVESTMENT SECTORS										
5/24/01	Sector Spreads to U.S. Treasuries Bills								Current Evaluation	Recommendation & Outlook for Coming Week
	60-90 days		120-180 days		180-270 days		360-450 days			
		6 mo. Avg.		6 mo. Avg.		6 mo. Avg.		6 mo. Avg.		
Sector US Treasury Bills	3.53%		3.56%		3.66%		3.88%			
Agency Discount Notes	0.34%	0.37%	0.30%	0.35%	0.18%	0.34%	0.17%	0.39%	CHEAP-FAIR HOLD OR BUY	Discount Notes offer value in the short term, comparable to BA's & CP.
Non-callable	0.35%		0.32%		0.20%		0.18%		FAIR HOLD OR BUY	Federal Agency Notes are in line with Agency D/N, sporadic supply.
Callable (1yr/3month)							0.19%		FAIR HOLD OR BUY	Callable securities were recently issued but offer limited value.
Bankers Acceptances	0.41%	0.42%	0.29%	0.39%					FAIR – CHEAP HOLD OR BUY	Comparable to CP and Agency D/N's, very limited supply
Commercial paper	0.42%	0.46%	0.34%	0.43%	0.22%	0.41%			FAIR – CHEAP HOLD OR BUY	CP is in line with D/N's, CD's, and BA's.
Repurchase Agreements (Term)	0.30%		0.25%						FAIR HOLD	REPO offers value short-term, O/N-1 week vs. Agency D/N's.

The Federal Reserve has been quite active in setting monetary policy, lowering the Federal Funds Rate by 250 basis points. The next FOMC meeting is scheduled for June 27. Some market participants are forecasting an additional 25-50 basis point cut at this meeting.

In this environment, the State LGIP should continue to offer good value. (Typically when interest rates drop swiftly, as they did throughout this year, money markets accounts, such as the LGIP, "lag" the market by offering a higher yield than can be obtained on the open market.) Commercial paper also offers good relative value throughout the short-term yield curve and would be the next best alternative for the County to invest short-term monies.

Provided below is a summary of PFM's recommendations.

- **Maintain allocation to Federal Agency obligations.** Yields on short-term maturities have continued to fall sharply during the first quarter. However, the yield spreads between U.S. Treasuries and Federal Agencies continue to be wide for short and intermediate maturities. For this reason, we recommend that the County continue to maintain a sector allocation target of 50% - 75% to the Federal Agency sector.

- **Maintain allocation to the State LGIP due to recent Fed rate decrease.** Yields on money market funds, such as the State LGIP, tend to lag the market. If short-term rates continue to fall, we recommend maintaining a significant allocation to short-term money market securities, such as the Washington State LGIP, to enhance returns.

- **Maintain portfolio average maturity within 9-10 months.** The average portfolio maturity slightly increased to 10.6 months during the quarter. This was slightly long of our recommendation. We suggest that the County allow the average maturity of the portfolio to drift lower by concentrating new purchases in shorter securities. This would allow for greater flexibility to make investments at favorable yields when interest rates rise.

- **Take advantage of wide yield spreads in the 2-year maturity range.** We would recommend that funds available to be invested longer term should be focused in Federal Agencies maturing in 12 to 24 months.

- **Maintain allocation to callables.** As of March 31, 2001, 13% of the County's portfolio remained invested in callable Federal Agency securities, unchanged from the previous quarter. At this time, PFM believes this is an appropriate level of call exposure and would not recommend adding any additional exposure to callables. If the County wishes to replace callable securities that are called or that mature with other callable securities, PFM recommends that low-coupon callables be purchased. These securities should provide better call protection given their nominal interest rate.

The sector and maturity composition recommendations below are based on our current market assessment, the County's investment objectives and limitations imposed by the County's investment policy.

Investment Sector	Recommended Average Maturity	Current Average Maturity	Recommended % of Portfolio	Current % of Portfolio
U.S. Treasury Obligations	9 months - 1.0 years	0.79 Years	5% - 15%	9%
Federal Agency Notes/Discount Notes	6 months - 2.0 years	1.20 Years	50% - 75%	65%
Municipal Obligations	6 months - 2.0 years	1.25 Years	0% - 5%	1%
Commerical Paper, Certificates of Deposit, Domestic Banker's Acceptances, State Pool	1 - 60 days	6 Days	20% - 40%	25%
Aggregate Average Maturity	**9 - 10 months**	**10.6 Months**		